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7E48 [redacted]	30Oct86

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NIC 05019-86
30 October 1986

NOTE FOR: Director of Central Intelligence

FROM: Deane E. Hoffmann
NIO for Economics

SUBJECT: Attached Paper on "The USSR's International Economic Breakout"

1. Attached is the CIA contribution to the National Security Study Directive on Soviet Initiatives in International Economic Affairs (NSSD 2-86). It analyzes Moscow's objectives in expanding its activities in international financial markets and international trade and business, highlighting the potential dangers to the system of greater Soviet participation.

2. [redacted] took the time last weekend to add material to the text based on the discussions you held in New York Friday. 25X1

Deane E. Hoffmann

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27 October 1986

The USSR's International Economic Breakout

Over the last several months, Moscow has launched a spate of initiatives that collectively portend a major increase in the breadth and depth of Soviet participation in international economic and financial areas. Many of these actions have received great publicity--the application for participation in GATT, the restructuring of the foreign trade apparatus and regulations on joint ventures, and the unexpected settling of outstanding Tsarist bonds. At the same time, however, the Soviets have quietly worked with Western banking and trading institutions to examine ways to significantly expand the range of financial instruments available to finance Soviet hard currency imports. 25X1

Soviet Motivations

Many of Moscow's recent initiatives have been little more than a repackaging of old proposals but they have been presented with greater skill and vigor than in the past. Heightened Soviet interest in expanding their economic links to the West can be ascribed to the confluence of several factors.

- Changes in senior economic management have resulted in the ascendancy of action-oriented individuals who realize that new tactics must be used to meet Soviet economic challenges, particularly modernization and accelerated growth. A revamped foreign policy apparatus is taking a more dynamic

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approach to Soviet international affairs, including economic issues.

- The reorganization of key domestic economic sectors and the foreign trade apparatus is an effort by Gorbachev to streamline the bureaucracy and allow it to respond to these challenges. The new trade policy team probably realizes that Soviet goals in the international arena have been frustrated in the past by conservative and ideologically constrained approaches and, in general, by a relative ignorance of the operations of the international financial and commercial markets.
- The need to develop a competitive Soviet export sector for manufactured goods has increased the pressure for Soviet representation in international economic organizations. Moscow feels that its current reliance on raw material exports for the bulk of its trade earnings is not consonant with its level of economic development and, moreover, makes it too vulnerable to fluctuations in world commodity prices.
- The recent deterioration in the Soviet hard currency position, the result of reduced earnings from both oil exports and arms sales, has driven the Soviets to explore alternative sources for financing imports.

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Improving Trade Effectiveness

Reorganizing the Foreign Trade Apparatus

In late September the Soviets announced a major overhaul of the Ministry of Foreign Trade. More than twenty ministries and seventy large associations and enterprises are to be granted authority to conduct trade directly with their foreign partners as of January 1, 1987. To carry out this trade, the ministries and production associations will have foreign trade organizations placed under their jurisdiction, many of which will be transferred from the MFT. [redacted] 25X1

Breaking the MFT's monopoly over foreign trade is clearly tied to Soviet efforts to expand exports of manufactured goods by strengthening the link between producers and world markets. In addition, it is designed to improve the efficiency of importing Western technology by giving end-users more say in contract negotiations. Under the current system, negotiations are drawn out and purchases often do not meet the requirements of end-users, as price considerations of the foreign trade organizations win out over technical specifications. [redacted] 25X1

While the MFT will continue to control a large portion of exports, it is conceivable that purchasing authority for most imports will fall to the various ministries. Included in the list of ministries being granted the right to conduct trade directly are the State Agroindustrial Committee (Gosagroprom), the State

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Committee for Supplies (Gossnab), the Ministry of Chemical Industry, and most machine-building ministries (see table 1). It is expected that in time additional ministries and enterprises could be granted autonomy over their trade transactions. [redacted] 25X1

At present it is uncertain as to exactly how funds will be allocated to cover imports but it appears likely that distribution of funds among the various sectors of the economy will continue to be centrally determined. [redacted] 25X1

As part of the reorganization, the Soviets have created a coordinating commission made up of the heads of the major ministries and departments engaged in trade activities. It is supposed to provide strategic guidance to the foreign trade sector; its command over resources, however, appears to be far less than that accorded to the state committees formed to oversee agriculture and

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TABLE 1

Soviet Ministries with Direct Access to Foreign Trade Partners as of 1 Janauary 1987

State Committees
- Gossnab (State Committee for Supplies)
- Gosagroprom (State Agroindustrial Committee)
- GKNT (State Committee for Science and Technology)*
- Goskomsport (State Sports Committee)*
- Goskomizdat (State Publishing Committee)*

Machine-Building Ministries
- Minenergomash (Ministry for Power and Machine Industries)
- Mintyazhmash (Ministry of Heavy Machine-Building Industries)
- Minelektrotekhprom (Ministry of Electrical Equipment Industry)
- Minavtoprom (Ministry of Automotive Industry)
- Minselkhozmash (Ministry of Machine-Building for Agriculture)
- Minpribor (Ministry for Instrument Making and Automation)
- Minstankoprom (Ministry for Machine-tool Building Industries)
- Minkhimmash (Minsitry of Chemical and Petroleum Machine-Building)

Other
- Mirmorflot (Ministry of Merchant Marine)*
- Minrybkhoz (Ministry of Fisheries)*
- Mingeo (Ministry of Geology)
- GUGK (Main Administration for Customs)
- Minkhimprom (Ministry of Chemical Industry)
- Minstroimaterialov (Ministry of Building Materials Industry)
- Minmedbioprom (Ministry of Medical and Biological Industries)
- Tsentrosoyuz (The Central Union of Consumer Cooperatives)*

*Entities already having some control over their foreign economic relations.

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construction. The commission's clout has been enhanced by the naming of V.M. Kamentsev, a recently appointed deputy chairman of the Council of Ministers with reportedly strong administrative and negotiating skills. The MFT and the State Committee for Foreign Economic Relations--which administers economic and military programs--will continue to monitor foreign trade operations but, at least for the MFT, with reduced power. VTB appears to have gained a greater role in controlling the distribution of scarce hard currency funds. 25X1

Joint Ventures with the West

Moscow is likely to complement increased end-user autonomy with the capability to conclude joint ventures with Western firms. The Soviets probably see several advantages to such a relationship.

- o Partnership with a Western firm would provide access to established markets and trademarks that could make it easier to sell Soviet-made goods in the West.
- o Quality control by the Western partner would help assure that products meet world market standards.
- o A long-term equity relationship with a Western firm could allow for automatic updating of production lines to keep up with changing Western demands and technology.
- o Joint ventures would also allow for transfer of technical know-how related to organization and management of production and the use of advanced technology that are not easily transferred through traditional equipment purchases.

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o Such arrangements would allow for the transfer of Western technology at little or no hard currency cost to the Soviets until after production begins. [redacted] 25X1

A framework for joint enterprises with other members of CEMA has recently been introduced and the Soviets appear willing to offer similar business opportunities to the West. High level Soviet officials have mentioned the possibility of joint ventures with Western firms on numerous occasions, both publicly and in private discussions with Western businessmen. [redacted] 25X1
[redacted] the Soviet leadership has passed a resolution that will 25X1 permit up to 49-percent foreign equity and allow for some management control, repatriation of profits, and other prerequisites to make such ventures attractive to Western firms. [redacted] 25X1

While joint ventures with the West appear to be the current buzzword among Soviet officials, there are a several other types of arrangements that the Soviets could pursue that would provide many of the same advantages. For example, buyback and coproduction arrangements would allow for access to Western markets, quality control, hard currency savings, and improved access to Western technology but with less direct Western involvement. Indeed, many of the discussions under the rubric of "joint ventures" appear to be little more than coproduction or buyback arrangements in the manufacturing sectors. [redacted] 25X1

[redacted] 25X1

25X1 [redacted]

Purchase of Western management services could also improve Soviet efficiency in introducing new technological processes and organizing production. Such arrangements should be particularly attractive to the Soviets in key sectors of the economy where they might desire to limit the extent of Western involvement such as in agriculture and the development of raw materials. Discussions along these lines had begun late last year but little has been said since the fall in oil prices and increased interest in joint ventures. [redacted] 25X1

Increased Financial Sophistication

Although the degree of actual borrowing has yet to be determined, Gorbachev's financial managers are clearly interested in taking full advantage of the wide range of Western financial markets and instruments in an effort to improve the effectiveness of Soviet borrowing activities. Past financial managers were extremely conservative in their financial dealings with the West--relying heavily on Eurocurrency borrowings and government-backed credits--and seemingly obsessed with obtaining the lowest nominal interest rate (to the point of allowing a substantial compensating markup in the cost of imported equipment). As a result, the USSR often paid more for its funds and received greater adverse publicity in doing so than other borrowers with an equal credit risk. [redacted] 25X1

VTB and Soviet-owned banks in the West are already adopting a more sophisticated approach:

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- Moscow Narodny Bank, the Soviet-owned bank based in London, recently put together a $100 million "note issuance facility" (NIF), a new instrument incorporating an option to issue notes as well as raise cash through bank advances. VTB has also recently accepted a French proposal to organize its own NIF.
- Last year, the Soviets agreed to an acceptance facility--a financing technique in which the bank guarantees payment to exporters for trade documents--with US and Canadian bankers for grain purchases. In August, VTB arranged a 100 million pound sterling bankers acceptance led by a British bank, the first time the Bank of England has permitted the Soviets to borrow in this manner. 25X1

The Soviets are also making unprecedented moves in world bond markets. In August, VTB agreed to invest $3.2 million in a yen-denominated bond issue, marking the first entry of the USSR into the international bond market. Most financial analysts believe that this venture is an indicator of Moscow's interest in marketing its own bond issues, a cheaper source of long-term funds than syndicated borrowing. Recent settlement with the British on Tsarist bonds in default since 1917 removes a long-standing impediment to the issuance of Soviet bonds. 25X1

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[redacted] 25X1

As part of its decision to broaden its financial dealings, the Soviets are moving aggressively to build the requisite expertise. [redacted] 25X1 Moscow also invited Western bankers to a financial seminar in mid-October to discuss management of the newer financial techniques and instruments as well as developments in marketing precious metals. [redacted] 25X1

The Soviets appear to have recognized that more sophisticated financial dealings entail expanding the number of their financial actors in the international arena. Moscow has renewed efforts to establish a branch of VTB in Tokyo [redacted] 25X1 Moscow has been negotiating with Kuwait to establish joint banking operations to fund projects in the USSR and in third countries. [redacted] 25X1

[redacted] 25X1

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<u>Interest in Multilateral Economic Institutions</u>

The Soviets are exploring the possibilities of expanding ties with a number of multilateral institutions. To some extent, increased participation in some international economic bodies goes hand in hand with Moscow's efforts to enhance its ability to boost exports. Yet such membership also provides Moscow with both an opportunity to expand its knowledge in this area and to gain new forums for political activism. Soviet actions to date do not appear to be as well thought out or as carefully planned as other recent moves on the trade front. In particular, years of neglect probably have left Moscow without a clear understanding of the costs and benefits of association with some of these international institutions. For example, Ivan Ivanov, head of the newly created MFA department for international economic issues told US Embassy officers that there were only 3 or 4 Soviet experts on GATT. Such inexperience was evident in Moscow's ill-timed and incorrect approach to the GATT at the Punta del Este meetings. 25X1

Despite the recent rebuff, Soviet interest in GATT remains keen, with an eye on eventually acceding to the agreement. The Soviets apparently believe that membership in GATT will expand their general knowledge of world economic conditions and trade opportunities and help to integrate the USSR into the international economy by making Soviet exports eligible for reduced tariffs. For example, negotiations during the upcoming round on services could affect

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Soviet activities in international shipping. The Soviets may also believe that GATT membership would make them less vulnerable to economic sanctions, although it is doubtful that governments would eschew such an option if they felt that sanctions were politically justified. [redacted] 25X1

Meeting GATT membership criteria may prove difficult, however. Soviet officials argue that the recent reorganization of the foreign trade sector make the Soviet economy more compatible with the aim of the GATT. Although the changes could help improve the efficiency of foreign trade, crucial trade decisions will remain centrally controlled. Thus, the Soviets still have not accepted the concept of free trade and international competition which form the basis of the GATT. Moreover, with no tariffs or quota systems, the Soviets have few direct concessions that they can offer in negotiations for accession to the GATT. Like other centrally planned countries that have acceded to the GATT, such as Hungary and Romania, Soviet concessions would have to incorporate commitments to increase imports from GATT signatories. The Soviets would have difficulty meeting such commitments, however, given current hard currency problems and only a limited potential for expanding exports. [redacted] 25X1

While the Soviets appear to view their initial participation within the GATT as a learning experience, in time Moscow might bring a strong political element to the GATT forum. The meetings could be used to criticize US actions or upset the decision-making

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process--which depends on consensus rather than votes--in favor of developing countries. Such interference would complicate procedures in an organization that already has difficulty in settling disputes. [redacted] 25X1

While there has been some reported interest in joining the IMF, Soviet officials have denied any intention of seeking membership. The USSR rejected IMF membership as too restrictive after participating in the organizing meetings as Bretton Woods in 1944. In particular, the USSR was unwilling to give up autonomy in setting their own trade and exchange rate practices, did not agree with the gold subscription requirements, and refused to release sensitive economic data such as gold reserves and balance of payments information. These factors are likely to continue to contribute to the Soviet lack of interest in the organization. In addition, as a large industrial nation, the USSR would probably join as a net creditor nation which would be a major departure from its policy of extending economic aid on a bilateral basis. [redacted] 25X1

Although we expect Soviet interest in the IMF to be weak, a number of factors could eventually cause Moscow to reconsider IMF membership.

- The size of the Soviet economy, from which voting shares are determined, makes it likely that the USSR would receive a voting share large enough to gain a seat on the Executive Board and put it in the position to influence important Fund decisions such as structure of the Fund, changes in

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quotas and allocation of SDRs.

- The Soviets also could use their position to influence decisions on lending to Third World clients. In particular, Moscow may believe its image could be enhanced as a lender within the IMF.
- Membership could could also help to expand Soviet exports as other members draw on the ruble portion of the Soviet subscription, which would account for 75 percent of the total and could only be spent on Soviet goods. [redacted] 25X1

One side benefit from joining IMF would be Moscow's ability to subscribe to membership in the World Bank (IBRD). The costs and benefits from joining the World Bank would be much the same as the IMF and thus, as with the IMF, World Bank membership is not likely to be particularly attractive to the Soviets, unless their involvement in international trade and finance increases considerably. [redacted] 25X1

The Soviets have been interested in establishing formal EC-CEMA ties since the early 1970s and have actively pursued this goal since the CEMA Summit in June 1984. Economic and trade issues probably were an important Soviet motive in earlier years but the present effort has a more pronounced political flavor. Moscow clearly wants some form of official recognition for CEMA by the EC to enhance the status of the organization within the international community. In addition, the Soviets probably hope to establish a

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forum to discuss the entire range of East-West issues with the West Europeans without the United States. Another longstanding Soviet goal has been to keep relations with the EC on a multilateral basis in order to block EC arrangements with individual East European countries. In a major concession last year to break the deadlock, the Gorbachev regime gave the green light for Eastern Europe to conclude bilateral arrangements with the EC, but Moscow is still likely to monitor closely the East Europeans' dealings with the EC. [redacted] 25X1

Other Soviet approaches to world institutions such as the <u>United Nations</u> have also had a decidedly political bent. The Soviets first broached their ideas about an economic security initiative in general terms at the UN last year. Soviet Foreign Minister Shevardnadze's 23 September address to the United Nations General Assembly included a strong pitch for a new, comprehensive system of international security--the Soviet theme that ties together all of Gorbachev's disparate disarmament and foreign policy initiatives. The economic component of Gorbachev's proposal calls for the establishment of a system of equal economic security, removal of economic blockages and sanctions, and creation of vehicles to handle the international debt problem. Included in this proposal is an effort to draw up principles to govern the use of part of the funds released from military budget reductions, which are also being proposed by the Soviets, to provide the LDCs with some economic relief. [redacted] 25X1

25X1 [redacted]

None of these ideas are new. The Soviets have simply resurrected outdated North-South themes--areas where the Soviet economic interests are small and the prospects for political visability are high. By weaving them together with other proposals on security and political issues into one overall framework, however, the Soviets are trying to create an illusion of newness and to lend concreteness to what Gorbachev calls "new political thinking" embodied in a series of proposals dating back to early 1986. Soviet initiatives have not met with much enthusiasm from the LDCs; in fact, Soviet and LDC interests on international economic issues have been diverging over the last decade. With a new set of policymakers in place and Gorbachev's call for new ideas, it is possible that in time the Soviets will propose some fresh ideas, particularly if the leadership is interested in taking a global approach to addressing international economic problems that affect their trade and financial position. 25X1

Future Soviet Actions

How Moscow proceeds relative to recent initiatives will depend, in large measure, on future leadership decisions regarding (a) the role of Western technology and equipment in Gorbachev's modernization drive, (b) the extent of Western managerial involvement and corporate ownership, and (c) the acceptable level of hard currency indebtedness. Moreover, it will take some time before these decisions are made:

o The leadership will likely spend the next year or two

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assessing the sufficiency of ongoing domestic programs--shifts in investment priorities, management reorganizations, and the discipline campaign--before reconsidering their conservative positions regarding Soviet reliance on foreign technology and equipment and systemic economic reform.

- It will take awhile for Gorbachev's new team of managers to acquire the experience and expertise necessary to confidently move heavily into the international financial and commercial arenas. [redacted] 25X1

Until the Soviets complete the formulation of their long term trade strategy, we can expect cautious but steady movement into the international economic arena. In the area of joint ventures, the first contracts could be signed as early as next year. Although with less fanfare, the Soviets are likely to encourage expansion of coproduction and utilization of Western management services. The Soviets are also likely to look for more opportunities to participate in joint projects in the Third World with Western firms. While the Soviets have used Western equipment to enhance the competitiveness of their bids on projects in the Third World in the past, they have rarely formed direct partnerships with Western firms when bidding on these projects. Arrangements like the one they are negotiating with Kuwait could provide the necessary funding without Moscow having to offer credits. More remote is the possibility of Soviet multinationals, primarily in cooperation with Western firms.

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Progress along these lines is apt to be slow. While some Western firms may be willing to make a relatively small investment to gain entry into the Soviet market, most are likely to take a wait-and-see attitude. Years of dealing with cumbersome Soviet bureaucracies, shoddy Soviet manufactures, and unimpressive results from joint ventures with other socialist countries will make most businessmen wary. The Soviets themselves are apt to approach actual negotiations cautiously. Granting the amount of Western control of production decisions that would be required by the Western parties would go against the grain of most Soviet managers. At present, it appears that there is still a considerable amount of uncertainty among mid-level Soviet officials who deal regularly with Western businessmen over what exactly joint ventures will entail. [redacted] 25X1

Even if impediments to successful joint ventures can be overcome, the level of investment is likely to be too small to have much of an impact on expanding Soviet exports of manufactured goods. Nor will the recent changes in the foreign trade apparatus likely have much success in expanding exports. Although they will probably improve the operation of trade by removing the MFT as a cumbersome middleman for some trade actors, the changes do not remedy the lack of domestic incentives for producers, the irrational price

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structure, and the inadequate technological base that underlie the poor position of Soviet manufactured goods in world markets. In addition, depressed earnings from traditional exports will severely constrain purchases of foreign equipment that could compensate for some of these shortfalls. [redacted] 25X1

How the Soviets will respond to lackluster export performance is difficult to predict. They are most likely to introduce piecemeal adjustments to deal with some of the specific problems that develop. They might try isolating the export-oriented producers and joint ventures from the inefficiencies of the economy, much as the defense industries are protected. However, the benefits of trade--especially in areas of technology assimilation and diffusion--would be similarly isolated. [redacted] 25X1

As long as Moscow continues its conservative approach towards reliance on Western technology, an increased role for the USSR in the international financial arena is unlikely. The Soviets will probably become more adaptable to new financial instruments and more flexible in the management of their assets. For example, [redacted] 25X1
[redacted] Soviet-owned banks are now permitted to hold 25X1
certain Western bonds in their portfolios. But the present limitations on Moscow's currency earnings, coupled with some vestiges of traditional Soviet conservatism, are likely to restrict sharply any large-scale speculative approaches to financial management. Gold trading and real estate scandals involving

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Soviet-owned banks and the resulting tightening of central control from Moscow are indicative of Moscow's attitude. 25X1

The Soviets will continue their approaches to a variety of multilateral economic organizations for both political and economic reasons. GATT will probably remain a key area of interest to the USSR both for the prestige factor and the chance to participate in negotiations which they consider will affect their interests. Lackluster trade performance and a trade sector that remains largely under the control of central authorities will, however, undermine Soviet arguements that their system is becoming more compatible with the aims of the GATT. 25X1

For largely political reasons the Soviets will continue to press for formal EC-CEMA relations although probably without expectations of anything but minimal economic gains. IMF and World Bank membership are not likely to be pursued actively at least not at the the present time. Disclosure requirements and less control over its economic aid are likely to deter any serious Soviet interest. Nor would the Soviet leadership be willing to accept being labeled as a developing country in order to get access to World Bank credits. 25X1

The USSR will almost certainly become more active in promoting its own solutions to international economic issues. It may perhaps go as far as proposing new international forums for dealing with such issues, especially if it feels strongly enough that it is being

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unjustly discriminated against by existing institutions. What forms the new Soviet proposals are likely to take are difficult to predict. We will probably see a repackaging of old proposals with slightly different nuances rather than bold new proposals. To the extent that the content of Soviet initiatives remains similar to past proposals, international response is likely to be lukewarm at best. In addition, the small Soviet share of world trade coupled with the expected lackluster trade and economic performance could weaken Soviet positions. 25X1

Impact of Soviet Actions

These Soviet initiatives will have substantial repercussions on US policy interests. To the extent that Soviet activities on international markets bring it closer to the international economic community, the West probably benefits since it gives the Soviets a greater stake in working to solve problems within the system. Such a stake, however, is not likely to weigh heavily in Soviet decisions where political and strategic interests are involved. 25X1

Increased cooperation with Western firms is likely to improve Soviet assimilation of Western technology at given enterprises, although diffusion throughout the economy is likely to continue to be difficult. Soviet ability to make effective use of Western equipment and technology has been constrained in the past, partly by the inability of Soviet managers and engineers to work hand-in-hand over an extended period with their Western counterparts. A vested

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interest by Western business in the effective use of Western equipment and technology, backed by a sustained on-site presence, could substantially improve their use. Moreover, Western firms involved in joint ventures with the USSR are likely to want to incorporate state-of-the-art technology into these projects and could press their governments to relax COCOM controls. Furthermore, joint ventures established outside the USSR or subsidiaries of joint ventures in third countries could give Soviet technicians greater access to controlled-technology without it being transferred onto Soviet territory. 25X1

Greater Soviet involvement in international trade and financial markets would make it easier for Moscow to hide the level of its financial activities through the use of numerous instruments such as interbank deposits, borrowing from non-bank institutions or banks outside the BIS reporting area. In the past, Soviet reliance on government-backed credits and a select grouping of major commercial banks in the US and Western Europe provided Western governments with the ability to effectively monitor, and, to some extent, control the level and terms of Soviet borrowing. 25X1

Increased trade with the LDCs could recoup some of the lost Soviet prestige and influence in the area. The Soviets would likely be willing to lend to debt-ridden LDCs at attractive rates to obtain contracts for projects, particularly those that would generate repayments in raw materials needed for the domestic economy. While

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this would not represent a shift from current Soviet policy toward the Third World, higher quality Soviet exports combined with LDC debt problems would make trade with the USSR more attractive than in the past. [redacted] 25X1

Greater Soviet activity in the international economy, especially in multilateral forums will increase the number of Soviet officials in the West and thus the opportunities for KGB activity. The intelligence activities undertaken as part of their participation in the United Nations offer a clear precedent in this regard. The opportunity to promote additional active measure campaigns would increase. This would be particularly true with respect to IMF decisions regarding financial support to various Third World applicants. [redacted] 25X1

If the regime decides in several years that it must rely more heavily on Western technology and equipment for its modernization efforts to succeed, we would expect to see a much bolder Soviet entry into the international economic arena and an even greater impact on US policy interests. Under such circumstances, we could expect a major increase in the flow of Western technology to the USSR with a commensurate rise in Soviet hard currency borrowing. Moscow's low indebtedness, substantial reserves of near-monies such as gold and energy, centralized control over resources, and large unexploited internal markets would make the USSR an attractive market for Western direct investment. [redacted] 25X1

[redacted] 25X1

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Western governments would have to contend with a growing interest group of manufactured goods exporters seeking more favorable trading conditions--low-interest credits, reduced export controls, better bilateral relations in general. The pressures from the business community would be even greater if the Soviets implement internal reforms that result in internationally competitive joint venture and equity arrangements. In fact, the Soviets could dangle lucrative trade deals in front of the Europeans and reiterate the theme of Pan-Europeanism to encourage them to adopt trade policies vis-a-vis the USSR that are at variance with US policy. A similar policy could be adopted with the Japanese. [redacted] 25X1

Increased Soviet understanding of how international financial and commercial markets operate carries a commensurate risk that Moscow may attempt to manipulate these markets to the detriment of US national security interests. The West has been moving towards globally integrated financial and commodity markets at a geometric pace. The capability to engage in financial, equity, and commodity transactions has outstripped international agreements on regulatory conditions. This fact, along with the rapid rise in transaction volume and the relative inexperience of many of the players has, in the minds of many experts, created the clear potential for an international crisis precipitated by one or more shocks to the system. Should Moscow gain the requisite expertise and market

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access, it is not inconceivable that the Soviets could effectively precipitate such a crisis without its role being known, for example, by the judicious placement of false data into the system or otherwise tampering with the worldwide transmission of financial or commercial information. We believe such actions would be unlikely, however, as long as the USSR's growing role is paying off in economic and even political dividends. If, on the other hand, Moscow perceives few economic benefits and remains a minor player in these markets, then the economic loss it would suffer would pale compared with the potential for significant damage to Western economic stability. 25X1

The USSR could conceivably employ such tactics for a variety of reasons.

- o Financial or commercial market disruption could be initiated to preoccupy the interests of Western governments at a time when the Soviets were engaged in activities--say in Eastern Europe or the Middle East--which would otherwise result in a united response from the alliance. In such cases Moscow would be seeking to disrupt rather than to irreparably damage Western trade and financial practices.
- o If the Soviets come to the conclusion that they cannot effectively compete with the West technologically and economically <u>and</u> that failure in this regard carries substantial risks to their long-term ability to maintain strategic parity, they could potentially opt to precipitate a

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major and sustained economic crisis in the West. According to some experts, such a crisis could be effectively started should shocks to the international financial and commercial markets quickly snowball to the point at which they cannot be effectively controlled by Western government, financial and regulatory institutions.

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